NOTES AND COMMENTS

SELECTED PRIORITY PROBLEMS IN SECURED FINANCING UNDER THE UNIFORM COMMERCIAL CODE

INTRODUCTION TO ARTICLE 9 PRIORITIES

A creditor who demands collateral for his loan seeks assurance that, in the event of default, his claim will be satisfied out of particular property of the debtor before that property is used to satisfy the claims of other creditors.[1] The secured creditor can obtain this assurance as against the subsequently arising judicial liens of general creditors by perfecting his interest.[2] Article 9 of the Uniform Commercial Code sets forth the prerequisites for perfection in section 9-303(1):

> A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken . . . .

The elements of attachment are enumerated in section 9-204(1):

> A security interest cannot attach until there is agreement . . . that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

In a few special cases, perfection entails no further action.[3] Normally, however, an additional step is required. When goods, documents of title or chattel paper are used as collateral, either possession by the secured party or the filing of a financing statement is necessary for perfection.[4] If contract rights, accounts receivable or general intangibles are used, the additional

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1. See UNIFORM COMMERCIAL CODE § 9-504(1) (procedures on default) [hereinafter cited as UCC; unless the 1958 Supplement is specifically indicated, citations are to the 1957 Official Text].

2. See UCC § 9-301(1)(b). The comment to this section states: "[T]he term 'perfected' is used to describe a security interest in personal property which cannot be defeated in insolvency proceedings or in general by creditors." An unperfected purchase-money security interest takes priority over a lien creditor for ten days after the secured party gives value, provided the interest is perfected within ten days. UCC § 9-301(2).

3. Interests which become perfected upon attachment are set forth in UCC § 9-302. They include: a security interest temporarily perfected in instruments or documents without delivery under § 9-304, or in proceeds for a ten-day period under § 9-306; a purchase-money security interest in farm equipment having a purchase price not in excess of $2,500, or in consumer goods (but filing is required for a fixture under § 9-313); an assignment of accounts or contract rights which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor.

4. UCC § 9-305 (possession); UCC § 9-302 (filing).

step is filing;[5] if negotiable or other instruments, possession.[6] Hence, perfection ordinarily consists of an agreement for attachment, the giving of value, the debtor's obtaining rights in the collateral, and filing or possession. It is achieved once all of these events have occurred, regardless of their sequence.[7]

The time at which these steps are taken generally determines the priority of conflicting security interests in the same collateral. Except for certain instances treated elsewhere in the Code, priority is governed by the rules set forth in section 9-312(5). If all competing interests are perfected by filing, the first filed prevails irrespective of the time of attachment.[8] An interest is deemed "perfected by filing" so long as filing is the step which, along with attachment, produces perfection; the fact that filing may precede all the elements of attachment is irrelevant.[9] When any competing interest is not perfected by filing, the order of perfection determines priority without regard to the time of attachment.[10]

Under the Code, collateral subject to conflicting security interests is applied initially to satisfy all debts covered by the security agreements of the creditor who has first priority.[11] Suppose, for example, that creditor *A* files a financing statement describing equipment which secures his loan of $50,000 to the debtor; and that, under the security agreement, the same collateral is to secure any future advances which the parties in their discretion may agree upon.[12] Suppose, further, that *B* then lends the debtor $25,000, to be secured by the same equipment, and that *B* perfects by filing subsequent to *A*. If *A* later makes an additional advance of $25,000, his superior rights in the collateral will extend to the entire $75,000 due him, inasmuch as time of attachment is irrelevant under the first-to-file rule.[13] Thus, on default, *B* will get nothing unless the collateral

5. UCC § 9-305, comment 1.
6. UCC § 9-304(1).
7. UCC § 9-303(1).
8. UCC § 9-312(5)(a) (1958 Supp.). UCC § 9-312(5) (1958 Supp.) provides:

> In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows:
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> (a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under Section 9-204(1) and whether it attached before or after filing;
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> (b) in the order of perfection unless both are perfected by filing, regardless of which security interests attached first under Section 9-204(1) and, in the case of a filed security interest, whether it attached before or after filing; and
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> (c) in the order of attachment under Section 9-204(1) so long as neither is perfected.

9. See UCC § 9-303(1) and comment 1.
10. UCC § 9-312(5)(b) (1958 Supp.), quoted note 8 *supra*.
11. UCC § 9-504(1).
12. UCC § 9-204(5) expressly validates the future-advances clause.
13. See UCC § 9-312, comment 4, example 4.

is sold for a net price in excess of $75,000. Similarly, even if the original agreement between *A* and the debtor provides only for the loan of $50,000 and not the future advances, a later agreement between them providing for an additional loan of $25,000 against the same equipment can enable *A*'s initial financing statement to accord both his loans priority. The later agreement, advances thereunder, and the debtor's acquiring rights in the collateral will cause *A*'s security interest covering the new advances to attach; and the filing made at the time of the original agreement will constitute the necessary step for perfection. By virtue of the first-to-file rule, *A* will have superior rights in the collateral for a total of $75,000. On the other hand, if the original security agreement between *A* and the debtor does not provide for future advances, and if the second advance by *A* is not accompanied by a security agreement specifying the equipment as collateral, *A*'s first filing would not embrace his subsequent advance of $25,000.[14]

A prospective lender, such as *B* above, who desires collateral unencumbered by prior liens may of course seek security in property not covered by any previously filed statement. Faced with a debtor all of whose present property is encumbered, the new lender can acquire a first priority by obtaining a security interest in new acquisitions. Assuming no earlier filing embraced after-acquired property,[15] the new lender, as the first to file and perfect an interest in the recent acquisitions, will have priority in them. If the filing of another party already covers those acquisitions, the new lender can still achieve priority through a purchase-money security interest. (Under the Code, a third party as well as the seller may be a purchase-money financer.[16]) When the collateral is other than inventory, a purchase-money security interest will attain priority over a conflicting interest if the purchase-money interest is perfected within ten days of the time the debtor receives possession of the collateral.[17] Priority is similarly available to a purchase-money financer of inventory, provided he both notifies parties whose conflicting claims are actually or constructively known, and perfects his interest before the debtor receives possession.[18]

A lender who attempts to utilize already encumbered property as collateral must determine the amount by which the value of the property exceeds the

14. See *ibid.*; UCC § 9-204, comment 8.

15. UCC § 9-204(3) expressly validates agreements encumbering "collateral whenever acquired."

16. A security interest is a "purchase money security interest" to the extent that it is
   (a) taken or retained by the seller of the collateral to secure all or a part of its price; or
   (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

UCC § 9-107.

17. UCC § 9-312(4) (1958 Supp.). Until this section was amended in December 1958, the interest had to be perfected before the debtor received the collateral.

18. UCC § 9-312(3) (1958 Supp.); see text following note 58 *infra*.

indebtedness which the property secures or is committed to secure. While the nature and extent of existing encumbrances need not be made a matter of public record under the Code's simplified system of notice filing, every filed financing statement must contain the name and address of the encumbrancer, so that prospective lenders can request the details of existing credit arrangements.[19] Taking advantage of section 9-208, a debtor who desires to borrow from a prospective lender can submit a statement of the collateral securing, and the amount due on, outstanding obligations. Should the encumbrancer, without reasonable excuse, fail to approve or correct the statement within two weeks, he would become liable for any loss which this failure caused the debtor; moreover, "the secured party may [then] claim a security interest only as shown in the statement against persons misled by his failure to comply."[20] Thus, a potential creditor can determine with certainty the exact amount of outstanding encumbrances—and make advances accordingly.

An already filed financing statement can, however, cover future advances by the prior encumbrancer; hence section 9-208 is of limited utility. Although the value of the collateral may support another loan, the second lender has no assurance that the first will not make subsequent advances which, by virtue of the latter's initial filing, will enjoy priority. Recall the above example in which the debtor obtained successive loans from *A* of $50,000 and $25,000 under an agreement providing for future advances (or, alternatively, under successive agreements). Suppose that before he repaid the $50,000 or received the $25,000 the debtor, seeking credit from *B*, submitted a statement to *A* erroneously indicating the outstanding obligation as $45,000; that *A* failed to correct the error; and that the debtor then showed the statement to *B*, who made a loan of $25,000. After *A*'s subsequent $25,000 advance, he would normally have priority as to the entire $75,000 due him.[21] But, having failed to correct a good-faith statement of the debtor, *A* may claim priority "only as shown in the statement," that is, in the amount of $45,000. Nonetheless, *A*'s neglect should result in a loss of priority only as to the $5,000 error on the first advance, and not as to the subsequent $25,000 advance. The uncorrected statement gave *B* no reason to think that *A* would not make future advances or that such advances, if made, would be subordinate to *B*'s.

Apparently, the draftsmen of the Code were anxious to discourage non-purchase-money multiple financing, and therefore did not protect intervening lenders like *B* against subordination to subsequent advances by a prior encumbrancer like *A*. Of course, so long as *A* voluntarily avoids taking more collateral than necessary adequately to secure his loan, *B* cannot complain. Since creditors generally prefer repayment to foreclosure, the wise lender will not tie up so much property that the debtor's ability to obtain necessary credit is impaired. Furthermore, competition among financing agencies may prevent any given lender from demanding excessive security. When collateral, originally reason-

19. UCC § 9-402(1) and accompanying comment.
20. UCC § 9-208(2).
21. See note 13 *supra* and accompanying text.

able in the light of expected debts, has for some reason become excessive, a loan agency seeking to preserve good will may voluntarily decide to surrender its priority as to future advances. On the other hand, an amply secured party in this situation may desire to retain its monopoly of the debtor's credit, even if the latter would prefer to acquire all future advances elsewhere.

A new lender can protect his interest in a variety of ways despite a prior secured party's refusal to cooperate. If the debtor's loan agreement with the first party permits accelerated payment, the new lender, anxious to establish a continuing relationship with the debtor, may lend him enough to repay the original loan. The debtor may then exact from the prior secured party a disclaimer of any security interest in the collateral.[22] Another but less certain protection of the new lender's interest may also be available. The debtor might promise not to accept future advances from his first financer unless the latter agrees that any claims in the collateral arising from the future advances will be subordinated to claims based on the intervening loans of the new creditor. Notice of this agreement could then be sent to the first secured party. Any advance made by that party after receiving such notice could be treated as subordinate to the new creditor's loans on the theory that the first secured party had induced the debtor to breach a contract.[23] Still, a court might hold that the breach left the priority provisions of the Code undisturbed; and that it gave the intervening lender a right to sue for damages—the amount by which the priority attaching to the first secured party's later advances prevented the second lender from satisfying his claims.[24] But the latter's status as an unsecured creditor of the first encumbrancer may not be equivalent to his position as a holder of a first-priority security interest in the assets of the original debtor. If the first encumbrancer becomes insolvent, the second lender may find himself in the position of a general creditor claiming dividends in the distribution of a bankrupt's estate. Besides, the fact that actions for dam-

22. UCC § 9-404(1). Such a statement may be presented to the filing officer who will remove the original financing statement from the files. UCC § 9-404(2).

23. When the party inducing the breach has knowledge of the existing contract and induces breach to gain the benefit of the contract for himself, he has the required tortious intention. See Imperial Ice Co. v. Rossier, 18 Cal. 2d 33, 112 P.2d 631 (1941). There may, however, be a question of causation. According to some courts, the mere entering into a contract with knowledge of a previous inconsistent contract is not in itself a "cause" of the breach of the prior contract. *E.g.*, Sweeney v. Smith, 167 Fed. 385 (E.D. Pa.), *aff'd*, 171 Fed. 645 (3d Cir.), *petition for cert. dismissed*, 215 U.S. 600 (1909). Some authority exists, however, for imposing liability on the later-contracting party. See, *e.g.*, Wade v. Culp, 107 Ind. App. 503, 23 N.E.2d 615 (1939). On procurement of breach of contract, see generally 1 HARPER & JAMES, TORTS §§ 6.5-6.8 (1956); Carpenter, *Interference With Contract Relations*, 41 HARV. L. REV. 728 (1928); Note, 40 COLUM. L. REV. 1094 (1940).

24. Damages for procuring breach of contract are ascertained as if the action were upon contract instead of tort. McNutt Oil & Ref. Co. v. D'Ascoli, 79 Ariz. 28, 281 P.2d 966 (1955). Damages are ordinarily limited to the actual loss incurred. Wade v. Culp, *supra* note 23.

ages necessitate the expense and delay of litigation may eliminate them as a commercially realistic alternative to priority.

Once a debtor who is a good credit risk and who requires additional financing ceases to deal with a prior encumbrancer, the encumbrancer's filed statement covering all available collateral can serve only to frustrate relations between the debtor and a would-be lender. The prospective lender cannot be sure that the debtor will refrain from accepting advances under the statement and thus further subordinating any claims that the would-be lender may make against the collateral. Moreover, the Code's policy of fostering a continuing relationship between the debtor and the prior encumbrancer can no longer be served since, by hypothesis, that relationship has deteriorated. In this situation, the debtor should be able to escape the inhibitions of a comprehensive financing statement—assuming he has not expressly bound himself to borrow only from the existing encumbrancer. The debtor's earlier assent to the statement should not be deemed to establish his consent to exclusive financing, because, perhaps anticipating purchase-money loans, he may not have been aware of the extent to which he could later be limited in acquiring outside credit. For this reason, means should be provided whereby a debtor can give a prospective lender adequate assurance that, despite an outstanding filing statement, the new lender will not be subordinated to later loans by the prior secured party. This assurance could be given if the Code were amended to authorize the debtor to file an effective, prospective repudiation of a filing statement on giving proper notice to the original creditor. The effect of such notice would be to limit the original creditor's priority under the outstanding statement to the amount then due him plus any amount which he is obligated to lend and the debtor to receive.

Priorities and Article 2 of the Code

Not all security interests arise under article 9. The article on sales (article 2) gives the seller and, in certain cases, a financing agency [25] various rights against the goods which are the subject of a sale. Some of these rights are considered security interests governed by article 9, as provided in section 9-113:

> A security interest arising solely under the Article on Sales . . . is subject to the provisions of this Article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods
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> (a) no security agreement is necessary to make the security interest enforceable; and
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> (b) no filing is required to perfect the security interest . . . .[26]

25. See notes 48-57 *infra* and accompanying text.

26. The section concludes: "(c) the rights of the secured party on default by the debtor are governed by the Article on Sales. . . ." UCC § 9-113. The article 2 provisions on default differ from those of article 9 in one major respect: a seller is not account-

An agreement is unnecessary to create the security interest, since it arises by operation of law in the course of a sales transaction.[27] Filing is dispensed with because the security interest is promptly liquidated, and because, as in the case of a pledge, the debtor does not have possession of the goods; third parties are therefore protected against reliance on ostensible ownership.[28]

The Seller's Security Interest

The seller's article 2 security interest consists of the right, upon buyer's default or insolvency, to withhold or stop delivery of goods in the hands of a carrier or other bailee. In addition, under section 2-505(1)(a), a seller may reserve "a security interest in the goods" by procuring a bill of lading. As a practical matter, the latter interest simply provides a way to implement the right to withhold or stop delivery.[29]

Under section 2-702(2), the seller has the additional right to reclaim goods upon demand made within ten days after receipt by the buyer, if the buyer received them on credit while insolvent. This right is probably not a security interest. If it were, and the debtor's possession of the goods were deemed lawful, section 9-113 would require the seller to obtain and file notice of a written security agreement in order to protect his right of reclamation against lien creditors.[30] But to make reclamation rights dependent upon compliance with the article 9 prerequisites for a security interest would be to render section 2-702(2) functionless, since the seller, by filing notice of a valid agreement, would derive from article 9 alone all of the rights provided by section 2-702(2), and more.[31] Unless section 2-702(2) is totally supererogatory, the right of reclamation is not conditioned on compliance with article 9 and is not, therefore, a security interest. Furthermore, although the comment to section 9-113 suggests that the right to withhold or stop delivery is a security interest, it makes no reference to the right to reclaim. This latter right is the Code's analogue to the seller's traditional remedy of rescission and recovery, available when goods have been delivered following the buyer's fraudulent misrepresentation of himself as solvent.[32] The introduction of a conclusive presumption of fraud resting on the fact of insolvency does not require a de-

able to the defaulting buyer for any profit made on a resale. UCC § 2-706(6). On the other hand, a financing agency holding an article 2 security interest (like a secured lender under article 9) must account to the buyer for any excess over the amount due on the debt plus the costs of sale. *Ibid.*; UCC § 9-504(2).

27. UCC § 9-113, comment.

28. See *ibid.*

29. See note 48 *infra.*

30. For UCC § 9-113, see note 26 *supra* and accompanying text.

31. Under the default provisions of article 9 (UCC §§ 9-501 to -507), the seller could take the goods to satisfy his debt without regard to the debtor's insolvency and even though demand for them was not made within ten days after receipt.

32. Hogan, *The Marriage of Sales to Chattel Security in the Uniform Commercial Code: Massachusetts Variety*, 38 B.U.L. REV. 571, 580 (1958).

parture from the accepted view that the right to rescind and recover is not a security interest.[33]

The seller's right of reclamation is inferior to a perfected security interest in the goods arising under an after-acquired property clause. Section 2-702(3) subordinates the seller's right to reclaim to the rights of a "good faith purchaser" under section 2-403, which in turn provides that "a person with voidable title has power to transfer title to a good faith purchaser for value." The buyer whose goods are subject to the seller's right of reclamation has "voidable title."[34] "Good faith" requires only honesty in fact;[35] "purchaser" includes the holder of a security interest;[36] and "value" exists when an interest is acquired as security for a pre-existing claim.[37] Consequently, the holder of a perfected security interest prevails over a seller attempting to reclaim goods delivered to an insolvent buyer.

The position of the reclaiming seller as against unsecured creditors is less clear. According to section 2-702, the right of reclamation is inferior to the section 2-403 rights of lien creditors. Section 2-403 says that the lien creditors' rights are governed by article 9. The only conceivably relevant provision in article 9 is section 9-301, which defines the rights of lien creditors vis-à-vis unperfected security interests; since the reclaiming seller is not exercising a security interest, his status in relation to lien creditors is undefined.

In the absence of a specific Code provision, local law is probably determinative. Before the Code, a defrauded seller could rescind and recover as against all unsecured creditors of the buyer, even though they may have levied on the goods before rescission.[38] An exception to this rule obtained in a minority of jurisdictions which granted priority to the lender who, relying on the buyer's ostensible ownership, had extended credit after the buyer had taken possession of the goods.[39] The seller's right of reclamation, though broadened by the Code's conclusive presumption of fraud, probably has the same priority over unsecured creditors as the seller's pre-Code right of rescission. This conclusion is confirmed by the comment to section 2-702 which, in explaining why the successful reclamation of goods excludes the seller's other remedies with respect to them, states that the right of reclamation "constitutes preferential treatment as against the buyer's other creditors." On the other hand, the comment appears to be contradicted by the statement in section 2-702 that the right to reclaim is "subject to the rights of lien creditors under this Article," a passage which misleadingly suggests that, somewhere, the Code permits the lien creditor to prevail. If uniformity is to re-

33. For the accepted view, see, *e.g.*, *ibid.*
34. See 3 WILLISTON, SALES § 567, at 208 (1948).
35. UCC § 1-201(19).
36. UCC §§ 1-201(32), (33).
37. UCC § 1-201(44)(b).
38. See Annot., 21 A.L.R. 1031, 1033 (1922) (collecting cases).
39. *E.g.*, Gilbert v. Hudson, 4 Me. 345 (1826); see Annot., 21 A.L.R. 1031 (1922).

place local differences on the rights of lien creditors, a clarifying amendment is needed.

Also unclear is whether the seller's right of reclamation will prevail against an unperfected security interest. If such an interest is sufficient to make the holder thereof "a good faith purchaser for value," it presumably enjoys priority.[40] The seller, however, is ordinarily superior to lien creditors,[41] and lien creditors are superior to holders of unperfected security interests.[42] Thus, the seller would seem to be superior to the holder of an unperfected interest.

Whether the seller will always be able to exercise his right of reclamation against the trustee in bankruptcy is even less clear. The preference given a seller who, on demonstrating fraud, rescinds and recovers has been held not to violate the bankruptcy objective of equal distribution among creditors of the same class.[43] The seller is regarded not as a general creditor but as the proper owner repossessing goods from one who has wrongfully deprived him of possession.[44] In the past, however, sellers who have prevailed against a trustee in bankruptcy were rescinding on the basis of some indication of actual fraud,[45] such as the buyer's being so hopelessly insolvent at the time he accepts the goods that he could not reasonably expect to pay.[46] If the Code right of reclamation given in section 2-702 is simply based on an expanded definition of fraud, then, presumably, the seller will prevail against the trustee as under prior law. Section 2-702 can be read, however, to grant a right to reclaim even when the buyer's insolvency after he receives the goods does not suggest actual fraud. In this situation, the seller's claim would be repugnant to the policy of equal distribution among creditors and for this reason may constitute a preference voidable in bankruptcy.[47]

The Financing Agency's Security Interest

Under section 2-506, a party which, by paying or purchasing for value a draft relating to goods, finances a sales transaction for either buyer or seller, obtains the seller's "rights . . . in the goods including the right to stop delivery . . . ."[48] Presumably, therefore, since reclamation is one of the sell-

40. See text accompanying notes 33-37 *supra.*

41. See notes 38-39 *supra* and accompanying text.

42. UCC § 9-301(1)(b). Unperfected purchase-money security interests have priority for ten days in accordance with UCC § 9-301(2). See note 2 *supra.*

43. See Annot., 59 A.L.R. 418 (1929) (collecting cases).

44. *Ibid.*

45. See COLLIER, BANKRUPTCY MANUAL ¶ 70.26 (2d ed. 1954); 3 WILLISTON, SALES § 637, at 457 & nn.3-4 (1948).

46. California Conserving Co. v. D'Avanzo, 62 F.2d 528, 530 (2d Cir. 1933).

47. See Bankruptcy Act §§ 60(a), (b), 30 Stat. 562 (1898), as amended, 11 U.S.C. §§ 96(a), (b) (1952); Yankwich, *Preferences Under Section 60 of the Bankruptcy Act,* 27 REF. J. 31 (1953).

48. (1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in

er's rights in the goods, a financing agency would succeed to that right.[49] On the other hand, section 2-707's enumeration of the rights of a "person in the position of a seller" includes the right to withhold or stop delivery but not the right of reclamation.[50] "Person in the position of a seller" is, nevertheless, a broader classification than "financing agency,"[51] and the more restricted grant of rights to the broader category ("person in the position of a seller") may be read not to limit the rights of a component of that class ("financing agency") under a separate provision.

If it does succeed to the right to reclaim, the financing agency can, in effect, acquire a limited type of security interest without meeting the requirements

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addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular on its face.

UCC § 2-506.

When a negotiable bill of lading covers the goods, the financing agency may enforce its right of stoppage by obtaining the bill from the seller and surrendering it to the carrier. See UCC § 2-705(3)(c). When a nonnegotiable bill has been issued, however, a carrier is not obliged to honor a stop order from one other than the consignor. UCC § 2-705(3)(d). If the seller rather than the financing agency is designated consignor, the financing agency may exercise its right of stoppage only through the seller. Presumably, a power of attorney from seller to financing agency authorizing the latter to issue a stop order in the seller's name upon buyer's default or insolvency would be repugnant to the statutory scheme. (The comment to UCC § 2-506 states: "This section does not attempt to create any new rights in the financing agency against the carrier which would force the latter to honor a stop order from the agency, a stranger to the shipment....")

Whether held by the seller or a financing agency, the right to stop delivery has priority as a purchase-money security interest. Under UCC §§ 9-312(3), (4) (1958 Supp.), until the collateral comes into the possession of the buyer, a perfected purchase-money interest prevails over conflicting interests. Thus, the seller or financing agency's right to stop delivery has priority over the rights of any other secured creditor of the buyer.

49. The language of UCC § 2-506, quoted note 48 *supra*, suggests a broad transfer of rights. The concluding clause can be read merely to enumerate specific rights rather than to limit the rights transferred. As a practical matter, a financing agency will not ordinarily need to exercise the right of reclamation. A bank discounting seller's draft will usually require a sight draft, so that it will be paid before the buyer obtains possession of the goods. A buyer's bank that contemplates a credit extension beyond the documentary phase of a given transaction will commonly have a prior security agreement.

50. "A person in the position of a seller may as provided in this Article withhold or stop delivery (section 2-705) and resell (section 2-706) and recover incidental damages (section 2-710)." UCC § 2-707(2). See the comment thereto.

51. "A 'person in the position of a seller' includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller." UCC § 2-707(1).

of article 9. Normally, exercise of the right to reclaim is contingent on demand made within ten days after the buyer's receipt of the goods.[52] When the seller repossesses promptly upon demand, the duration of his secret lien is no greater than that possible under the twenty-one day automatic perfection which the Code gives his unfiled interest in documents released to a buyer.[53] When, however, a written misrepresentation of solvency was made to the seller within three months of delivery, the ten-day limitation does not apply.[54] Although some promptness in reclaiming must probably be exercised—lest the right of reclamation be lost on the ground of laches or on the theory that retention of possession by the buyer was fraudulent as against his creditors [55]—, the seller, and the financing agency succeeding to the seller's right, still have for an indefinite time a right in the goods which prevails against lien creditors and the trustee in bankruptcy. This right, if in the seller, is based on actual fraud, and may therefore be unobjectionable.[56] In contrast, the seller's financer, relying on the seller's credit rather than the buyer's, arguably should not receive priority over the buyer's creditors. And the buyer's financer, who necessarily looks to the buyer's credit, should be expected to perfect a security interest in the latter's goods before being allowed to prevail over lien creditors.

Ample ground exists for holding that reclamation is not a section 2-506 "right in the goods," and for denying that right to a financing agency. Viewed as a right to rescind for fraud, reclamation could be deemed personal to the seller. Furthermore, though not a security interest when exercised by the seller, the right to reclaim might be considered such an interest when acquired by a financing agency. Section 9-113 would then require filing and a security agreement for the continued perfection of the interest.[57] While the Code could thus be construed to deny reclamation to financing agencies, this result should not depend on the vagaries of judicial interpretation. A clarifying amendment should specify that the seller's right to reclaim does not pass to the financing agency.

THE PURCHASE-MONEY SECURITY INTEREST

Section 9-312 and the December 1958 Amendments

By enabling the holder of a purchase-money security interest to achieve priority, the Code permits the debtor with already encumbered property to present prospective creditors with attractive security for additional loans. If the proferred collateral is other than inventory and if the lender's interest is

52. UCC § 2-702(2).
53. UCC §§ 9-304(4), (5).
54. UCC § 2-702(2).
55. See 3 WILLISTON, SALES § 648, at 488 & nn.3-4 (1948, Supp. 1958).
56. See text accompanying notes 43-46 *supra*. If the seller's right to reclaim is entirely independent of fraud on the part of the buyer, the right may be voidable as a preference in bankruptcy. See text following note 46 *supra*.
57. Note 26 *supra* and accompanying text.

perfected before or within ten days after the debtor receives possession of the collateral, first priority is assured.[58] If the collateral is inventory, a creditor who wants to attain priority by virtue of being a purchase-money financer must comply with the following provisions of section 9-312(3) (as amended, December 1958):

(a) [T]he purchase money security interest is perfected at the time the debtor receives possession of the collateral; and

(b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and

(c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

Controversy exists as to whether the requirement of notice will adversely affect the debtor's opportunity to procure credit.[59] Much purchase-money financing is for the purpose of supplying small businessmen the low-cost funds necessary to obtain purchased goods from a carrier with promptness and without extra storage charges.[60] It has been argued that the time required to inspect public records and notify parties having security interests in the collateral at issue will hamstring small businessmen-borrowers in need of instant, short-term loans.[61] Under the Code's centralized and simplified system of notice filing, however, the existence of a previously filed conflicting interest can easily be ascertained.[62] And, when speed is essential, a telephone

58. UCC § 9-312(4) (1958 Supp.).

59. NEW YORK LAW REVISION COMM'N, STUDY OF UNIFORM COMMERCIAL CODE—MEMORANDA PRESENTED TO THE COMMISSION AND STENOGRAPHIC REPORT OF PUBLIC HEARING ON ARTICLE 9 OF THE CODE 1133-42 (Legis. Doc. No. 65(H), 1954).

60. *Ibid.*

61. *Ibid.*

62. See UCC §§ 9-401, -402.

Before the Code, security interests in personal property took such forms as the chattel mortgage, conditional sale, bailment lease, trust receipt, and factor's lien. See Gilmore, *Chattel Security*, 57 YALE L.J. 517, 761 (1948). If recording was required, each different interest might be filed in a different place. UCC § 9-101, comment. Not only was title searching made difficult for third parties, but security interests could be invalidated if they turned out to be filed in the wrong set of records. *Ibid.*; UCC § 9-401, comment 5; Birnbaum, *Article 9—A Restatement and Revision of Chattel Security*, 1952 WIS. L. REV. 348, 383. And under the detailed filing requirements of many states, the slightest error in describing the property or parties would invalidate the interest. *E.g.*, General Motors Acceptance Corp. v. Haley, 329 Mass. 559, 109 N.E.2d 143 (1952) (designation of "E. R. Millen Co., Inc." as "E. R. Millen Company" rendered the filing statement invalid).

Under the Code, a single security agreement may provide for advances to be secured by both present and after-acquired property, UCC § 9-204(3), and by any proceeds re-

call to a secured party of record will effect adequate notification—unless the doubtful integrity of that party dictates written communication.

Any inconvenience occasioned by the notification requirement seems reasonable so long as it subserves the financing of inventory which is constantly sold and replenished. The Code, by abolishing the rule that the lender must police his collateral [63] and validating the after-acquired property clause,[64] provides lenders with readily available security and borrowers with correspondingly accessible sources of credit. It encourages a relationship whereby the inventory financer makes periodic advances, since he does not have to refile for each advance.[65] This relationship merits the protection which notification by purchase-money lenders achieves. The general inventory financer is thereby alerted that new acquisitions are encumbered; he can then refuse to make additional advances, and demand payment out of the proceeds received when his collateral is sold by the debtor.[66]

Before the 1958 amendments, section 9-312(3) required that notice be given "any secured party . . . who has previously filed a financing statement covering the same item." If "previously" meant previous to making each of a series of purchase-money advances rather than previous to filing notice of an intention to make the advances, the purchase-money lender who wished to achieve priority under 9-312(3) was saddled with the burdensome necessity of checking the records before every individual advance. Furthermore,

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ceived on disposition of that property, UCC § 9-306. The agreement may also provide that security shall be collateral for both present and future advances. UCC § 9-204(5). Filing is made as simple as possible. All security interests in personal property may be filed in a single set of records, unless the state adopts an optional provision requiring local as well as central filing. UCC § 9-401. (Security interests in fixtures are to be filed where a mortgage on the real estate concerned would be filed or recorded. UCC § 9-401(1)(b).) The filing statement need only contain the signatures and addresses of the lender and borrower, and a description of the collateral by item or type. UCC § 9-402(1). If the details of the credit transaction are desired, third parties may consult the lender and borrower. UCC § 9-402, comment 2. A filed statement is effective for five years and is renewable without limit. UCC § 9-403.

63. UCC § 9-205.

64. UCC § 9-204(3).

65. UCC § 9-402, comment.

66. UCC § 9-312(3), comment 3.

The basis of the notice requirement in § 9-312(3) is that, since a general inventory financer expects to make periodic advances on the basis of incoming inventory, he ought to be notified if any of the incoming goods are subject to a superior, unfiled security interest. The notice requirement is imposed, however, only when the incoming goods are subject to a superior interest of the purchase-money type, even though unfiled superior interests can also arise under the first-to-perfect rule. If a pledgee perfected an interest in goods by possession prior to the time that the general inventory financer perfected through filing, the superior interest of the first to perfect continues even after the goods are released to the debtor, provided the erstwhile pledgee's interest is then filed. To protect the general inventory financer, the first to perfect could be allowed to maintain his priority after possession is surrendered only if he gives notice at that time to any filed interests. See notes 113-15 *infra* and accompanying text.

the pre-1958 Code was not clear on whether a purchase-money lender who failed to give proper notice was automatically subordinated to conflicting security interests, or whether he could still obtain priority under some section other than 9-312(3). Last December's amendment to section 9-312(5) indicates that a purchase-money financer who does not achieve priority under 9-312(3) may still do so under either the first-to-file rule of section 9-312 (5)(a) or the first-to-perfect rule of section 9-312(5)(b).[67] The unamended 9-312(5) had declared, simply and ambiguously, that it applied to "all cases not governed by other rules stated in . . . section [9-312]." And the comment to the old section 9-312 had gone on to say that "subsection 5 does not apply to any case where one of the conflicting interests is a purchase money interest, since all such cases are covered by subsections (3) and (4)."[68] The statement in 9-312(3) that the purchase-money interest prevails "if" notice is given was thus read "only if" notice is given. Under this interpretation, a purchase-money financer who failed to comply with 9-312(3) could not obtain priority under either subsection (a) (first-to-file) or (b) (first-to-perfect) of 9-312(5).[69]

In cases in which the purchase-money financer has filed ahead of any conflicting interest, requiring him to give notice before each advance would prevent him from taking full advantage of the filing system.[70] Commonly, he has entered into a security agreement with a debtor who is seeking to finance future purchases of inventory by utilizing prospective inventory to secure a succession of purchase-money advances.[71] The first-to-file rule should be applied to this type of transaction, since it allows "the secured party who has filed first to make subsequent advances without each time having, as a condition of protection, to check for filings later than his,"[72] and since it therefore facilitates the maintenance of a continuing series of advances and repayments between borrower and lender. Credit is readily available for the bor-

67. "In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows: . . . ." UCC § 9-312(5) (1958 Supp.).

68. UCC § 9-312, comment 4. See UCC § 9-312, reason for change (1958 Supp.). If the draftsmen had intended that purchase-money lenders should not win except under § 9-312(3), specific language to that effect could have been used. On its face, even old § 9-312(3) defines priority only for situations in which the purchase-money lender has given notice prescribed by that section. If the purchase-money lender did not give notice, he would then be outside the reach of § 9-312(3), and priority would be determined by the general principles of § 9-312(5), quoted note 8 *supra*.

69. See UCC § 9-312, comment 4.

70. "Notice filing has proved to be of great use in financing transactions involving inventory, accounts and chattel paper, since it obviates the necessity of refiling on each of a series of transactions in a continuing arrangement where the collateral changes from day to day." UCC § 9-402, comment 2.

71. Such an arrangement is permitted by UCC § 9-204(3).

72. UCC § 9-312, comment 4.

rower; the lender has a steady customer; and cheaper financing is fostered because the borrower's credit standing need not be continually re-established. The purchase-money lender's filing constitutes a public record that future advances may be secured by incoming inventory. If these advances were secured by the same inventory but intended to finance the conduct of ordinary business operations, the lender could achieve priority over other parties in the absence of notification.[73] That the advances actually constitute the purchase price of new acquisitions should not, and since last December, does not, make notification any more necessary.

The principal difficulty presented by the old section 9-312(3) was not that known parties had to be notified, for generally no conflicting security interest would exist, but rather that the records had to be re-examined repeatedly to discover whether another financer had appeared on the scene. Under the present 9-312(3), this burden has been removed: the priority of a purchase-money financer who has filed depends only on his notifying those persons who have previously filed (or whose conflicting interests are actually known to him). If the conflicting interests were filed after the purchase-money interest, no notice whatever is required, because the purchase-money lender, though he has not complied with 9-312(3), has priority as the first to file under 9-312(5)(a). And since his name and address are on record, the holders of conflicting interests can make inquiries of him if they wish to protect themselves.

The First-To-Perfect Rule

In contrast with the operation of the first-to-file rule, applying the first-to-perfect rule in the context of a purchase-money lender who fails to give notice engenders complex priority problems not amenable to happy solution. Consider the following situation. A general inventory financer, *I*, advances money to a debtor and files a financing statement covering all of the debtor's inventory. Subsequently, the debtor's purchase-money financer, *PM*, honors a draft which the debtor's seller has drawn, and thus finances the debtor's purchase of new goods. *PM* receives in return a negotiable bill of lading covering the goods in the hands of a carrier; he later releases the bill to the debtor, who delivers it to the carrier and obtains his goods. *PM* then files his security interest.

PM's perfection of a security interest in the goods arises through his perfection, by possession, of a security interest in the document of title.[74] So long as he retains the document, he will enjoy priority over *I* or any holder of "an earlier security interest even though perfected."[75] Once the document is

73. See text accompanying notes 13-14 *supra*.

74. UCC § 9-302 provides for perfection of a security interest in negotiable documents by possession.

75. UCC § 9-309. In the example posited, the buyer's bank is financing purchase of the new acquisition through a long-term extension of credit. A buyer's bank could also limit its role to the documentary phase of a given transaction, demanding payment from

released to the debtor, *PM*'s interest remains perfected for twenty-one days without filing, since the debtor's possession of the document is for the purpose of eventually selling the goods.[76] If *PM* files a financing statement within twenty-one days, his interest is continuously perfected from the time he originally perfected an interest in the document.[77] Since, in determining priority, a continuously perfected interest which was originally perfected otherwise than by filing is treated as at all times perfected otherwise than by filing,[78] priority is governed by the first-to-perfect rule of section 9-312(5)(b).[79]

Unless postponed by explicit agreement, the perfection of *I*'s security interest occurs when value is given, the debtor "has rights in the collateral," and any step necessary for perfection—in this case, filing—has taken place.[80] *I* filed and gave value on making his general loan; his interest therefore perfects as soon as the debtor acquires rights in the collateral. If, at this time, *PM* has not yet taken all the steps necessary to perfect his interest, *I*'s interest will perfect first and, under the first-to-perfect rule of section 9-312 (5)(b), *I* will have priority. On the other hand, if, by the time the debtor has rights in the collateral, *PM* has also given value and taken any other steps necessary for perfection, the interests of both *I* and *PM* will perfect at the same time—when the debtor obtains rights. Since, in this event, the Code does not accord priority to either party, their interests are presumably on a parity.

The time at which the debtor acquires rights in the collateral may thus be of crucial importance. Unfortunately, aside from providing that "rights includes remedies,"[81] the Code does not attempt to set forth what is meant by "rights in the collateral." The hypothetical debtor being a buyer, the time as of which he "has rights" must be determined under the article on sales.

The first rights which accrue to the debtor-buyer are those arising upon identification of the goods to the contract of sale. At that point, he receives

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the buyer before releasing the bill of lading to him. In such a case, the bank would be offering credit analogous to that ordinarily offered by a bank that discounts a seller's draft. Section 9-309 gives priority to banks engaging in purely documentary financing presumably to protect negotiability and on the ground that the banks are engaging in short-term, self-liquidating transactions. As a holder in due course of the document of title, the bank would prevail over an earlier security interest in the goods even though perfected. This special priority is limited, however, to the documentary period, and would be ineffective after the bills were released to the buyer. Upon release, if the bank has not been paid, priority of any security interest retained would depend on the rules set forth in UCC § 9-312 (1958 Supp.).

76. UCC § 9-304(5)(a).

77. "If a security interest is originally perfected in any way permitted under this Article and is subsequently perfected in some other way under this Article, without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this Article." UCC § 9-303(2).

78. UCC § 9-312(6) (1958 Supp.).

79. See note 8 *supra*.

80. See notes 2-10 *supra* and accompanying text.

81. UCC § 1-201(36).

an insurable interest and, absent an express agreement to the contrary, "a special property" in the goods.[82] Should the seller become insolvent within ten days after receiving the first installment on the purchase price, a buyer who has a special property and who has paid for the goods in advance may recover them from the seller by tendering the unpaid portion of the price.[83] In the case of a seller's breach, identification prior to breach empowers the buyer to replevy the goods unless he is able to make a substitute purchase or unless the seller's article 2 security interest has not been satisfied.[84] Identification also entitles the buyer to a right of action against any third party who has wrongfully dealt with the goods.[85]

If the special property and insurable interest arising on identification are not deemed to constitute sufficiently substantial rights in the goods to support a security interest, *I*'s security interest will probably be held to perfect when title passes to the buyer. Except when the parties have explicitly agreed otherwise, the buyer obtains title to the goods "at the time and place at which the seller completes his performance with reference to . . . delivery of the goods . . . ."[86] Since the delivery of a document of title at another time and place is irrelevant,[87] the terms of shipment are determinative. If, for example, the contract reads "f.o.b. destination," title passes upon tender at destination;[88] if "f.o.b. point of shipment," when the goods are turned over to the carrier.[89]

Considerable support can be mustered for the view that title passage is a prerequisite of attachment (and hence of perfection). Under traditional theory, the location of title determines whether the creditors of the buyer or of the seller have the right to levy upon the goods;[90] and, with exceptions not here pertinent,[91] the Code does not purport to change the law of creditors' rights.[92] Arguably, the lien of a secured creditor of the buyer should not attach to goods while they are still subject to levy by creditors of the seller, particularly since the Code nowhere attempts to resolve the otherwise result-

82. UCC § 2-501(1). UCC § 2-401(1) requires the express contrary agreement.
83. UCC § 2-502(1).
84. UCC § 2-716(3).
85. UCC § 2-722.
86. UCC § 2-401(2).
87. *Ibid.*
88. UCC § 2-401(2)(b).
89. UCC § 2-401(2)(a).
90. See, *e.g.*, Laughlin Motors v. Universal C.I.T. Credit Corp., 173 Kan. 600, 251 P.2d 857 (1952); Wheeler Lumber, Bridge & Supply Co. v. Shelton, 146 Ore. 550, 29 P.2d 1013 (1934).
91. UCC § 2-402(1) provides that the rights of unsecured creditors of the seller are subject to the buyer's right to recover the goods under §§ 2-502 and 2-716. Under § 2-402(2), local law determines when retention of goods sold by the seller is fraudulent as to creditors, except that "retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent."
92. See UCC § 2-402, comment.

ing conflict of interests. A second argument rests on the fact that the time of title passage can generally be ascertained more easily than that of identification—which may occur at some vague point before shipment.[93] Title might therefore appear to provide a more satisfactory point at which to say the debtor now "has rights in the collateral" than does identification. Furthermore, the right to replevy against the seller rests not on identification alone but also on the buyer's inability to obtain substitute goods,[94] or his having satisfied the seller's security interest in the goods,[95] or his having prepaid a portion of the price to the seller who becomes insolvent within ten days thereafter.[96] Hence, the right in the goods which identification makes possible may actually arise only when one of these other conditions occurs.

Although identification alone may not give the buyer rights in the goods with respect to the seller, it may give the buyer sufficient rights vis-à-vis third parties to permit a security interest in his creditor to attach. Once identification occurs, the buyer has a "right of action" against third parties wrongfully dealing with the goods.[97] If he is thus enabled to recover the goods themselves (rather than or in addition to damages), then his "special property" in the goods on their identification yields a right effective against anyone but the seller. Such a right in the buyer appears substantial enough to justify the recognition of a security interest in a creditor of the buyer. If the security interest attaches before title passes, the resulting conflict between the secured party and the seller's creditors is easily resolved on the assumption that, whether the security interest is perfected or not, the secured party will have no greater right against the seller's creditors than would the debtor-buyer. So assuming, a court could hold that the special property obtained on identification of the goods is a sufficient right to support attachment; that (in the hypothetical situation) *I* perfected on identification for the purpose of determining his rights against other secured parties such as *PM* and against unsecured creditors of the debtor-buyer; but that *I*'s perfected interest is, nevertheless, subordinate to the rights of the seller's creditors so long as those creditors would prevail against the buyer—that is, so long as the seller retains title.

The need to protect the general inventory financer (here, *I*) with respect to after-acquired property suggests that the debtor should be considered to obtain rights in the collateral upon identification. Financers like *I* frequently make advances on the basis of new acquisitions.[98] The Code's general policy

93. UCC § 2-501, pertaining to identification, provides that in the absence of explicit agreement otherwise, when the contract is for the sale of future goods other than crops, identification occurs when the "goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers." See UCC § 2-501, comment 2.

94. UCC § 2-716(3).

95. UCC § 2-716(3).

96. UCC § 2-502.

97. UCC § 2-722.

98. See generally Dunham, *Inventory and Accounts Receivable Financing*, 62 HARV. L. REV. 588 (1949).

is to encourage a continuing relationship between a borrower and lender in the position of *I* and his debtor, so that a good security interest can be maintained with a minimum of expense, uncertainty and record-searching.[99] Accordingly, a parity interest in *PM* should be avoided. Permitting him to attain such an interest without his having given notice to, or filed before, *I* will discourage the latter from making new advances. But if title passage is deemed the point as of which the debtor "has rights in the collateral," the interests of *I* and *PM* could perfect simultaneously, for *PM* might have taken all other steps necessary to perfect his interest in the document of title before rights vested in the debtor. In contrast, were identification held to perfect *I*'s interest, perfection would occur before possession by *PM*, and *I* would have priority as the first to perfect—except in the rare case in which *PM*'s taking possession constituted identification. Thus, if identification is characterized as the time at which the debtor receives rights sufficient to support a security interest, parity interests ordinarily can be avoided.

Designating identification as the time when a buyer acquires rights in the collateral also avoids problems raised by the ambiguous language of section 9-304(2): "During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto." This section enables *PM*—once he has perfected his interest in the goods by possessing, or filing his interest in, the carrier's bill of lading—to defeat all parties who perfect their interests in the goods, but not in the bill, while the bill is outstanding.[100] If the priority thus accorded *PM* by 9-304(2) is limited in time to the documentary period (the period during which the bill is outstanding), that section makes his interest superior to fewer conflicting interests than does section 9-309, which grants "a holder . . . [of] a negotiable document" priority over all interests irrespective of when they perfected.[101] Section 9-304(2) can be read as other than a truncated redundancy, however. Broadly construed, it would extend *PM*'s priority over interests perfecting during the documentary period beyond the expiration of that period; such priority would continue after *PM* had surrendered the bill and continued the perfection of his interest through timely filing.[102] Thus, *PM* could file sub-

99. UCC §§ 9-101 and 9-402, comments.

100. An ambiguity is raised by the language "and any security interest in the goods otherwise perfected during such period is subject thereto." "Otherwise perfected during such period" can be read to mean any interest enjoying the status of perfection during the period. Such a reading would give priority to the party perfecting an interest in the document over all earlier perfected interests irrespective of the time of perfection. In all likelihood, however, "otherwise perfected during such period" refers to interests which were actually perfected during the period.

101. Such a purchase-money financer would seem to qualify as the "holder" of a "duly negotiated" document envisaged by UCC § 9-309. See UCC § 7-501 and comment.

102. Under UCC § 9-304(5), a secured party holding a perfected interest in a document has twenty-one days in which to file his interest after releasing the document to

sequent to the documentary period and defeat parties who, during the documentary period, perfected interests previously filed in the goods but not the document. This result would permit him to avoid the requirements of section 9-312(3), which, when applicable, compel a purchase-money lender to give earlier filers "notification . . . before the debtor receives possession of the collateral" in order to attain priority over them.

Earlier filers such as *I* can receive the protection of 9-312(3) if priority is not determined by 9-304(2). The latter section governs priority solely with respect to interests perfected "on goods covered by documents."[103] Therefore, absent notice under 9-312(3), *I* can attain priority as against *PM* by perfecting his interest before the bill of lading is issued. Since *PM* did not perfect until receiving the bill, *I* would thus acquire priority under the first-to-perfect rule of section 9-312(5)(b).

If the debtor's rights arise upon identification and identification occurs before shipment, that is, before the goods are embodied in the bill of lading, the perfection of *I*'s interest would precede the goods' being "covered by documents"; hence, *I* would have priority under section 9-312(5)(b). If, however, the debtor's rights depend on title passage and title does not pass before shipment, *I*'s interest would perfect while the goods are "covered by documents"; 9-302(2) would therefore establish *PM*'s priority. *I* could still avoid the subordination of his interest in this situation by including documents in his original financing statement.[104] Then, should title pass after shipment or on *PM*'s possessing the bill, both lenders would perfect an interest in the goods by perfecting an interest in the bill. And, under section 9-304(2), neither would enjoy priority. Should title pass on shipment, *I* would receive priority as the first to perfect, since *PM* would not obtain possession of the bill until later.

Even if the debtor's rights date from identification, *PM* might be able to gain parity. His interest could be construed as a continuation of the seller's automatically perfected article 2 security interest, consisting of the right to withhold or stop delivery of the goods.[105] Since this interest passes to *PM* when he pays the seller and receives the bill of lading,[106] and since it remains perfected without filing until the debtor takes possession of the goods,[107] *PM* can argue that his security interest is, in effect, the extension of an already perfected interest. So viewed, his interest would be continuously perfected

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the debtor for eventual sale or exchange of the goods. UCC § 9-303(2) would make his interest continuously perfected from the time of perfection through possession of the document.

Literally read and broadly construed, UCC § 9-304(2) would extend *PM*'s priority beyond the documentary period even in the absence of perfection through filing. Doubtless, no court would permit this result.

103. UCC § 9-312(1).
104. UCC § 9-304(1).
105. UCC § 2-506(1).
106. *Ibid.*
107. UCC § 9-113.

from the time of identification, which was when the seller's interest perfected.[108] *I* also having perfected at that time, *PM* would thus achieve parity.

The reasons already advanced for fostering the relationship between a general inventory financer and his borrower dictate that the article 2 security interest not be treated so as to award *PM* parity. This result appears consonant with article 9, which can be read to allow only a variously perfected article 9 interest to be "perfected continuously."[109] More important, the seller's security interest which devolves on *PM* is fundamentally different from the interest which he can assert against the goods once the buyer has possession. The essence of the seller's interest is the power to withhold or stop delivery before the buyer possesses the goods. After the buyer takes them, however, *PM* can no longer exercise the right of stoppage derived from the seller. Unlike the seller's article 2 interest, any security interest which *PM* then holds exists not because of the secured party's status, but because of a security agreement under which *PM* extended credit to the buyer. *PM* perfected this (article 9) interest when he acquired the bill of lading. Having already perfected by then, *I* would enjoy priority.

Despite the difficulties which the first-to-perfect rule can present, its application may have merit when, before any other interest is filed, *PM* advances money against documents and perfects a security interest by possessing them.[110] Suppose that *I* then files and that later, the documents having been released to permit the debtor to obtain the goods, *PM* files.[111] If section 9-312(3) controlled, *PM* could not achieve priority over *I*, a prior filer, without giving him notice. But *PM* could not reasonably be expected to give notice on perfecting his interest, since *I* at that time had not yet filed. Hence, the December 1958 amendment of the Code, assuring *I* priority under section 9-312(5)(b) when, as here, he is the first to perfect, might seem justified.

Even here, however, the first-to-perfect rule could produce undesirable consequences. On filing, *I* cannot determine whether an outstanding lien, perfected through documents and without filing, will subsequently be filed when the debtor obtains the goods represented by the documents.[112] *I* may therefore either run the risk of making a future advance against previously encumbered collateral, or else feel compelled to reinspect the public records before making such an advance. Both alternatives seem inconsistent with the Code sections which enable the general inventory financer (here *I*) to protect his interest through notice filing, and which require that a purchase-money

108. See UCC § 9-303(2), quoted note 77 *supra.*

109. See *ibid.* UCC § 9-113 makes article 2 security interests generally "subject to" article 9, but does not classify these interests as "perfected . . . under" article 9. Since the latter phrase defines interests capable of continuous perfection by virtue of UCC § 9-303(2), literal reading would preclude such continuity.

110. See UCC § 9-305.

111. This filing produces an interest perfected continuously from the time of perfection through possession of the document. See text accompanying notes 75-77 *supra.*

112. For pertinent Code provisions, see UCC §§ 9-304(5), 9-303(2).

lender notify the holder of an earlier-filed interest in inventory.[113] For this reason, once *PM* files an interest in the goods, he could be allowed to attain priority over *I* only by giving him prompt notification, and not allowed priority as the first to perfect. Achieving this result would involve amending the notification section, 9-312, so that a purchase-money lender who perfected before filing could not, after filing, attain priority over the holders of earlier-filed interests unless he notified them in a timely fashion. Implementing such a notification requirement would also necessitate restricting *PM*'s section 9-304(2) priority—which arises without notice being given under 9-312(3)—to the period during which his interest is perfected by virtue of its having attached in the bill of lading.[114] Thus, section 9-304(2) would have to be amended to correlate priority thereunder with documentary perfection.[115] The foregoing amendments would protect *I* should he file between perfection and filing by *PM*. They would also remove the many ambiguities arising from the interplay of priorities under sections 9-304(2), 9-312(3), and the first-to-perfect rule.

113. See UCC §§ 9-101, comment, 9-402, comment, 2. Compare note 66 *supra*.

114. For this period, see UCC § 9-304.

115. In addition, such an amendment would solve the conceptual problem found in the second paragraph of note 102 *supra*.